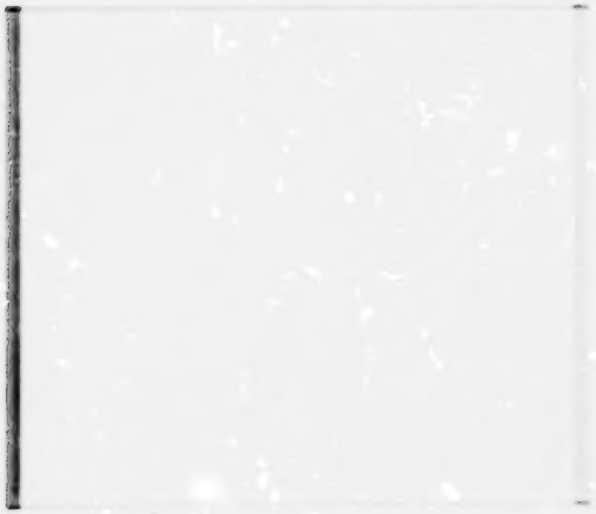
Province of British Columbia
Ministry of Finance and Corporate Relations



REPORT OF THE SUPERINTENDENT
OF FINANCIAL INSTITUTIONS
TO THE HONOURABLE MEL COUVELIER,
MINISTER OF FINANCE
AND CORPORATE RELATIONS

RE: THE FORMER TEACHERS' INVESTMENT
AND HOUSING CO-OPERATIVE

August 15, 1987

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EXECUTIVE SUMMARY

INTRODUCTION

In October 1986, the Honourable Elwood Veitch, then Minister of Consumer and Corporate Affairs, directed the new Superintendent of Financial Institutions to conduct an internal investigation into the failure of the uninsured Teachers' Investment and Housing Co-operative (TIHC).[1] This is the Superintendent's report of findings.

The TIHC was incorporated in 1951 as the B.C. Teachers' Federation Co-operative Association. Thereafter, it began to receive funds from members in the form of loan certificates and to lend these funds to members as mortgages. The co-operative expanded rapidly in the early 1970's. In 1973, it changed its name to the Teachers' Investment and Housing Co-operative. Branch offices were opened in the Interior, on Vancouver Island and eventually in Alberta and Manitoba. By then, a variety of financial services were offered including specialized mortgage and savings programs designed for teachers, retirement savings plans, travel services and commercial loans.

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1. It should be noted that the TIHC is not linked in any way with an existing Teachers' Credit Union operating in the Province of British Columbia.

After 35 years of operation, the TIHC was dissolved in June 1986. Its 45,000 investors lost approximately $70 million in retirement savings and investments.

The financial distress of the TIHC was attributed by various parties to the effects of the Western Canadian recession on the TIHC's investments compounded by its lack of deposit insurance. The recession had a particularly severe impact on the co-operative's investments in development properties in Alberta and in a trust company purchased in 1983. The co-operative's 1984 financial statements showed a loss of $5.5 million. Efforts to secure deposit insurance had been unsuccessful for over a decade. Member confidence was further shaken by the collapse of the Canadian Commercial and Northland Banks in September 1985. On November 4, 1985, the TIHC closed its doors and was placed into interim receivership under the Bankruptcy Act of Canada.

The primary reasons for the Superintendent's inquiry were to establish the facts surrounding what went wrong with the TIHC; to respond to the concerns of members and other parties; and to recommend how a similar case might be prevented in future. All evidence was submitted to the Superintendent on a voluntary basis.

The primary conclusion of the inquiry is that the Teachers' Investment and Housing Co-operative philosophically exceeded its mandate as a co-operative. Arising from this and other conclusions are a series of recommendations about trusteeship, auditors, standards of care, and investment practices of financial institutions. The need for individual investors to seek information concerning conditions of their investments, particularly with respect to deposit insurance has also been reinforced in the Superintendent's mind. The Superintendent recommends the Co-operative Association Act be amended to clearly prohibit operation of such institutions under that act and to provide that the Superintendent, through the courts, may act in the public interest should a similar situation arise in the future.

DETAILED FINDINGS

A number of factors converged to cause the failure of the TIHC. Although the TIHC may have been able to weather any one of the factors which are described in this report, their convergence proved fatal. Findings are organized according to objectives set for the inquiry.

1.0 Legislative Mandate

In its daily operation the TIHC must be considered to have exceeded the spirit, if not the letter, of its mandate. The TIHC did not remain closely held and it provided services to non-members. The TIHC neither communicated directly or conscientiously with members, nor do members appear to have successfully held their Board of Directors accountable. Further, the TIHC was operating as a "deposit-taking institution" under what is essentially an act which allows registration but does not provide regulation or membership protection similar to those acts governing operations for other financial institutions.

The TIHC's purchase of Norfolk Trust Company in April, 1983 is also questioned. It is the opinion of the Superintendent of Financial Institutions that the TIHC had an insufficient capital base to support the trust company operation. The purchase stretched its mandate and threatened the co-operative's future solvency.

2.0 Business Practices

At the time of dissolution the co-operative held investments in member mortgages, commercial loans and real estate. Historically, member mortgages were the primary service offered by the TIHC. Traditionally, its residential mortgage portfolio performed excellently.

In the 1960's, the TIHC began to diversify from member loans into commercial loans and rental properties. Although there are some questions about TIHC procedures surrounding commercial loans, there are major concerns about its investments in real estate, particularly Calgary development properties purchased in 1981 as joint ventures with two Calgary real estate salesmen. In 1984, the real estate portfolio represented nearly one quarter of total assets.

Given the nature of member accounts or "investments," the Superintendent considers these investment practices imprudent, and a major factor contributing to the eventual failure of the co-operative. Raw land is high risk investment. By prudent standards for financial institutions, reserves of the TIHC were inadequate to cover investments with this degree of risk. Investments in five development properties represented over 400

per cent of reserves. That fact alone should have caused concern among Board and management.

There is no question the Board of Directors was very committed to, and involved in, the affairs of the TIHC. However, their considerable collective experience as Board members was apparently insufficient when it came to operating the type of institution the TIHC had become. Internal control procedures appear to have been inadequate. There is little evidence the Board saw fit to challenge management actions over time.

Finally, the audit system appears to have been an inadequate source of external control on the operations of the TIHC. The 1984 financial statements are reported to have met professional and legal standards of disclosure. Nevertheless, the Superintendent of Financial Institutions believes these statements did not provide understandable warning signals for unsophisticated investors.

3.0 Misrepresentation

No evidence of intentional or fraudulent misrepresentation to investors came to light during the inquiry. Nevertheless, a number of important sources of confusion existed. The overriding source of confusion was the TIHC's appearance as a financial institution. It acted like a credit union in some ways, even though it was not legally incorporated as one. The public understandably perceived the TIHC as a regulated and protected financial institution when, in fact, the co-operative was operating under a registration act and without a safety net of any kind.

Misperception was fuelled by confusion arising from the relationship of the TIHC to the B.C. Teachers' Federation (BCTF); different trust relationships for the Retirement Savings and Deferred Salary Leave Plans (created in 1969 and 1980 respectively); and 1984 financial statements. Confusion was neither maliciously, nor consciously perpetuated by the Board, management or staff of the TIHC. Investors must also take some responsibility for securing their own information about the nature of the institution they are dealing with. Nevertheless, there is no evidence that the co-operative made a conscientious effort to communicate to its members that their funds were at risk.

4.0 Criminal Acts

The Corporate Investigations Branch of the Ministry of Finance and Corporate Relations investigated aspects of the cooperative's joint ventures in Alberta real estate. The Branch also examined whether TIHC management, directors or officers made fraudulent withdrawals of personal funds during the 1984-1985 period.

No evidence was found of any statutory offences, in these areas, on the part of the Board of Directors, management or any other persons involved with the operation of the Teachers' Investment and Housing cooperative.

5.0 Deposit Insurance

In 1977, the TIHC began its unsuccessful quest for deposit insurance. For over a decade, negotiations were pursued primarily with the provincial Credit Union Reserve Board (CURB) [later the Credit Union Deposit Insurance Corporation (CUDIC)]. The stalemate seems to have arisen over the issue of investment powers, particularly the kinds of investments the TIHC preferred. Positions adopted by the parties involved appear unchanged from beginning to end.

In essence, the TIHC was not a credit union. This created what were ultimately insurmountable technical and political problems with respect to qualifying for deposit insurance. The TIHC remained uninsured and vulnerable to the lack of member confidence which contributed to its demise.

For the Ministry, a dilemma was the recognition that the TIHC was a deposit-taking institution. Deposit insurance was seen to be crucial. However, the TIHC was an investment vehicle and the government cannot guarantee such ventures.

CONCLUSIONS

Problems faced by the Teachers' Investment and Housing Co-operative were evolutionary. The TIHC was a specialized institution, extremely successful at providing mortgages for teachers. Its expansion and diversification beyond its resources and skills was risky. The decline in real estate values and weakness of commercial loans caused by the Western Canadian recession exacerbated the problem.

Furthermore, decisions which fundamentally changed the nature of TIHC operations were seen to be incremental. This is especially true for the development property purchases in Alberta and the 1983 trust company purchase. While at the

time these were seen as simple expansions of existing practices, their impact on the co-operative's operations was fundamental. No one involved appears to have realized this, including the Board members, management or the provincial government. The Superintendent concludes this is partly because the TIHC operated under a statute which neither enabled nor required the detection of these kinds of circumstances.

RECOMMENDATIONS

Lessons about financial institutions and about legislation can be learned from the story of the Teachers' Investment and Housing Co-operative. Specifically, the Superintendent recommends:

(1) Information about the meaning of trust relationships should be required to be disclosed by financial institutions to their customers.

(2) The role of the auditor in a financial institution should be more carefully delineated to ensure the function of external control -- independence and obligations to members or shareholders -- remains paramount. Higher standards of communication should be required between auditors, regulators and investors.

(3) The application and appropriateness of generally accepted accounting principles (GAAP) to financial institutions should be evaluated.

(4) Higher standards of care should apply to Boards of Directors of financial institution than for other institutions.

(5) Investment practices of financial institutions should be closely monitored according to prudent portfolio standards. Regulatory and stabilization procedures should be designed to allow imprudent transactions to be rectified immediately.

(6) Investors should actively seek information concerning conditions under which they invest, particularly the degree of risk and the existence of insurance.

A lesson about legislation is that the public may be unable to distinguish between regulatory and enabling acts. Statutes designed for minimal government intervention should provide power to investigate and seek remedy should serious problems arise. Specifically the Superintendent recommends that:

(1) Legislation should not allow a financial institution, whatever it is called, to escape close regulation and monitoring.

(2) The Co-operative Association Act should not be a vehicle for establishing and operating a financial institution.

(3) The Co-operative Association Act should be amended to clearly prohibit operation of a deposit-taking or financial institution under its auspices, and to provide the Superintendent with appropriate powers and remedies to prevent another case like that of the Teachers' Investment and Housing Co-operative.

INTRODUCTION

In October 1986, the Superintendent of Financial Institutions was asked to inquire into the failure of the Teachers' Investment and Housing Co-operative (TIHC).[1] This is the report of the Superintendent's findings.

When the uninsured Teachers' Investment and Housing Co-operative (TIHC) was dissolved in June 1986, its 45,000 members lost approximately $70 million in retirement savings and investments. Dissolution followed attempts to continue the co-operative which had filed a holding proposal and was placed under interim receivership on November 4, 1985. In May 1986, members accepted dissolution and a restructuring proposal to allow eventual recovery of 74 cents on the dollar.

An ad hoc committee of TIHC investors circulated a petition in June, 1986 for a ministerial inquiry. The request failed to meet requirements under the Co-operative Association Act [section 48(2)]. Instead, the Honourable Elwood Veitch, then Minister of Consumer and Corporate Affairs, directed the new Superintendent of Financial Institutions to conduct an internal investigation into the failure of the TIHC with an eye to preventing a similar event in the future.

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1. The TIHC is not linked in any way with an existing Teachers' Credit Union operating in the Province of British Columbia.

Specific objectives for the investigation were:

1. to determine whether the Teachers' Investment and Housing Co-operative exceeded its legislative mandate while it was in business;

2. to review loans, investments, internal controls, reserve practices and other activities of the co-operative to see if unsound business practices were evident in decisions made by executives or the Board;

3. to investigate allegations of misrepresentations made to investors;

4. to determine whether there was self-dealing, fraud, conflict of interest or non-arm's length transactions; and,

5. to consider whether legislation governing co-operatives needs improvement.

This report provides a brief history of the TIHC, the Superintendent's conclusions about reasons for failure and legislative implications of the failure. Evidence was gathered with the assistance of the Corporate Investigations Branch of the Ministry of Finance and Corporate Relations; Mr. Peter Podovinikoff, Chief Executive Officer of the Delta

Credit Union, acting as an independent consultant; and the Interim Receiver, Mr. Martin Linsley of Coopers and Lybrand Limited. All evidence was submitted on a voluntary basis. Those who participated are to be thanked for their efforts to help the Superintendent fulfill the inquiry objectives.

The primary conclusion of the inquiry is that the Teachers' Investment and Housing Co-operative philosophically exceeded its mandate as a co-operative. Arising from this and other conclusions is a series of recommendations about trusteeship, auditors, standards of care, and investment practices of financial institutions. As well, it is recommended that the Co-operative Association Act be amended to clearly prohibit the operation of such institutions under that Act, and to enable the Superintendent, through the courts, to act in the public interest should a similar situation arise in future.

BACKGROUND

1.0 History

The co-operative was incorporated in 1951 as the B.C. Teachers Federation Co-operative Association and had 129 members at the end of its first year. It received funds from members in the

form of loan certificates and loaned them, in turn, to other members as mortgages.

The co-operative expanded rapidly in the early 1970s. By 1971, membership had surpassed 15,000. Assets stood at almost $40 million. The co-operative offered a variety of financial services, including specialized mortgage and savings programs designed for teachers, retirement savings plans, travel services and commercial loans. In 1973, the co-operative changed its name to Teachers' Investment and Housing Co-operative. By 1975, there were seven branch offices in Vancouver, Victoria, Nanaimo, Kelowna, Prince George, Edmonton, Calgary and Winnipeg. Membership then totalled 26,760 and assets $133 million. Trust company services were also offered through a subsidiary.

The Board and management recognized the co-operative was a deposit-taking financial institution. They began attempts in the mid-70's to acquire deposit insurance. From 1977 until its demise, the TIHC unsuccessfully engaged in negotiations to acquire deposit insurance with the Credit Union Reserve Board (CURB) [later the Credit Union Deposit Insurance Corporation (CUDIC)] in British Columbia, private insurers such as Lloyds of London, and eventually through a direct guarantee by the provincial government. Reasons why the TIHC was unsuccessful in securing back-up by deposit insurance or a government guarantee are discussed later in this paper.

2.0 Events Prior to Failure

The foundation of the TIHC was its residential mortgage portfolio. However, member investments were also reinvested into a variety of vehicles including development, rental and commercial property in British Columbia, Alberta, Manitoba and Arizona; commercial mortgage loans; long and medium term marketable securities. As well, the TIHC acquired a controlling interest in Norfolk Trust Company in 1983. Norfolk was subsequently merged with Discovery Trust and renamed Discovery Trust Company of Canada.

In 1970, net mortgage loans to members comprised 64 per cent of the TIHC's $26.6 million in assets. By 1982, that percentage had fallen to 31 per cent of $305.5 million and 30 per cent in 1984. At the same time, investments in land and rental properties had risen from about 7.0 per cent in 1970 to 25 per cent by 1984.

Around 1980, TIHC began a joint venture with two Calgary real estate salesmen to acquire several development properties in Alberta, mostly in Calgary. In March, 1980, the Board passed a resolution "that management be given full power and authority to sell and purchase real property as it finds necessary." According to management, this resolution was rescinded in January 1983 because of concern over the

increased percentage of assets devoted to development properties. As of November 1985, the book value of these properties was approximately $46.5 million, or roughly 50 per cent of the outstanding real estate portfolio. The remaining 50 per cent represented rental and commercial property in British Columbia and Alberta.

The economic decline throughout Western Canada in 1982-1983 and specifically, the dramatic drop in Calgary real estate prices and values, caused the value of properties held by the co-operative to fall substantially below original acquisition cost. Even without a write-down of development properties, the 1984 financial statements showed a loss close to $5.5 million.

Publication of this information in the annual report of the co-operative in early 1985 aroused some member concern and withdrawals. Publication of two stories about the absence of deposit insurance in the Vancouver Sun just prior to the annual meeting in April 1985 caused further withdrawals. As a result, the Board of Directors of the co-operative wrote to the Minister of Consumer and Corporate Affairs in May 1985 requesting the support of the provincial government in securing deposit insurance.

Through the summer of 1985 the co-operative continued to accept member investments. At the same time, the co-operative continued efforts to obtain deposit insurance. Investor confidence needed for the co-operative to continue operating was further undermined by the failures of the Canadian Commercial Bank and the Northland Bank in the fall of 1985.

Subsequent to meetings with the Minister of Consumer and Corporate Affairs in October 1985, on November 4, 1985 the Teachers' Investment and Housing Co-operative was placed into interim receivership through a holding proposal filed by the directors under the federal Bankruptcy Act.

3.0 Events Following November 4, 1985

Martin Linsley of Coopers and Lybrand Limited, the court appointed Interim Receiver, assumed responsibility for the business affairs of the co-operative following filing of the holding proposal. From November 1985 to May 1986, he conducted information meetings with members of the co-operative and developed a restructuring proposal.

On May 11, 1986, over 98 per cent of participating members voted to accept an amalgamation with CanWest Financial

Corporation of Winnipeg and a restructuring proposal to eventually return them 74 cents on the dollar.[2] On June 23, 1986, the Teachers' Investment and Housing Co-operative dissolved and amalgamated with CanWest Financial Corporation of Winnipeg.

4.0 Reasons for TIHC's Failure

The primary reasons for this inquiry are to establish what went wrong with the TIHC; to respond to concerns of members and other parties; and to recommend how similar situations might be prevented in future. Opinions differ about the causes of the TIHC's failure.

Members

Members regret the dissolution of a co-operative which served teachers for so many years. There are some tragic stories of individual loss. Although over half of the investors lost under $50, 1,000 lost in excess of $20,000; 15 lost over $80,000. Some investors contend there was misrepresentation of the risks involved with investments in the co-operative.

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2. Following Supreme Court of British Columbia approval of the restructuring, the TIHC amalgamated with Arbutus Holdings Co-operative to create a different fiscal year-end for tax purposes. The value of the restructuring was increased from 71½ cents to 74 cents. An April 1987 Revenue Canada tax ruling will allow a 50 per cent deduction as business investment loss for the remaining 26 cents on savings accounts and term deposits.

One example cited is that the co-operative conducted itself and purported to be operating in a manner similar to banks and credit unions. Financial products offered were similar to those offered by banks. Co-operative staff are alleged to have described the institution as financially sound and "as solid as the Rock of Gibraltar" even as late as November 1985.

Members also contend losses or potential losses to which they were exposed were not properly represented to them in the TIHC's 1984 annual report, at the 1985 annual meeting, or at any other time. In particular, many new investors appeared to be unaware of the precarious position of the co-operative. Others have questioned the auditors' performance.

Further, some members allege the Board was guilty of certain wrongdoing; namely not fully disclosing problems which dated back to 1981, permitting members' money to be invested in "wild and speculative land dealings" and not taking corrective action soon enough.

Finally, some contend the Superintendent of Co-operatives and the government failed to protect members interests, particularly in allowing the co-operative to act in a position of trust as a deposit-taking institution but

without regulatory, reporting, or other requirements common to credit unions and other regulated financial institutions.

Interim Receiver

Responding to specific questions, the Interim Receiver attributes the co-operative's demise almost entirely to the decline in real estate values in Western Canada which resulted in losses on real property and commercial loans as well as on co-operative's investment in Discovery Trust. He further suggests the seeds of the co-operative's problems were sown some years prior to 1985 and that the overall deficiency suffered by investors would probably not have been materially different if the co-operative had ceased business earlier in that year.

Commenting on allegations some of the development property acquisitions were speculative, the Interim Receiver noted that some of the land owned by the co-operative was purchased with a view to either reselling at a profit or holding it for development. Other land had been purchased and resold at a profit within a relatively short time frame. He also commented on some documentary deficiencies in the TIHC's property

files. For example, there was no standardization of filing or procecdures for property pruchase. It is not known whether these deficiencies existed prior to dissolution.

The Interim Receiver questioned the wisdom of the Norfolk Trust purchase. The co-operative's book equity was less than the cost of the Norfolk shares at the time of purchase. So, a portion of the purchase price was financed through TIHC investment accounts, a form of debt. The Interim Receiver considers this to have been unwise since Norfolk's equity was itself levered by customer deposits.

The Interim Receiver also notes the majority of TIHC members did not obtain copies of the 1984 annual report and financial statements. He questions whether those few who did, fully appreciated either the extent of the co-operative's financial problems or their potential impact on investors.

Board of Directors and Management

The Board of Directors and management of the TIHC lay blame on the faltering economy compounded by problems with Discovery Trust Company, and ultimately, by the

Ministry's view that TIHC was an investment group and not structured like a credit union. Therefore, it could not guarantee the provision of deposit insurance.

Reasons for winding up are identified by the Board as poor performance of commercial loans and mortgages and reserves required in the trust company. Although the decline in Alberta property values caused considerable devaluation of real estate investments, directors and management believe the TIHC would have survived the recession had there been deposit insurance.

Board and management stress the co-operative was formed in 1951 to provide specialized services to teachers in rural areas, particularly to women who were unable to get loans from traditional financial institutions. The co-operative could provide services that a credit union could not and operated before deposit insurance existed. They say that they eventually showed willingness to convert to a credit union, but were refused permission, and claim there was no political will to help them survive.

Inquiry Consultant

Mr. Peter Podovinikoff, Inquiry Consultant, writes that the failure of the Teachers' Investment and Housing

Co-operative has left scars which will not be easily be healed. He notes further that the losses suffered by these members were unique. Money lost was furnished from members' savings and did not represent risk capital investments.

Reasons cited for failure include a combination of actions by a wide assortment of people, economic conditions, and the inability of any one party to assist the co-operative. In particular, he concludes that Board members did not seem to understand the full implications of either decisions they were making, or approvals they were granting. According to his assessment, the government could have stepped in as early as 1982 to respond to concerns it was aware of surrounding the operation of the TIHC.

FINDINGS

In some respects, the problems and the fate of the TIHC resemble, on a smaller scale, those of the Canadian Commercial and Northland Banks. The Superintendent concludes that the recession was only one of a number of factors which converged to cause the failure of the TIHC. While the co-operative may have been able to survive any one of these damaging factors, their convergence proved fatal.

1.0 Legislative Mandate

Two aspects are particularly noteworthy with respect to whether the TIHC exceeded it legislative mandate. One relates to its ongoing daily operation and the other to its 1983 purchase of Norfolk Trust Company.

In daily operation, the TIHC must be considered to have exceeded the spirit, if not the letter, of its mandate. The Co-operative Association Act enables persons to form an association to operate on a co-operative basis. Each member has one vote and services are primarily for members.

The TIHC did not remain closely held and services were eventually provided to non-members. (Approximately 30 per cent of Retirement Savings Plan holders were non-members.) Investors were based throughout British Columbia, Alberta and Manitoba. In its last years of operation, TIHC also launched efforts to expand into Ontario.

The TIHC did not communicate directly or conscientiously with members. Annual reports were sent only on request and received very limited circulation.

The Interim Receiver estimates no more than two per cent of the members received these reports. (Non-member investors had even more remote information avenues.) Few members attended

annual meetings. There is little evidence to suggest the members of the TIHC made a concerted effort to inform themselves, or to hold their Board of Directors accountable.

For all intents and purposes, TIHC operated as a "deposit-taking institution" under what is essentially a registration act which does not provide regulation or protection similar to that provided under the regulatory acts governing financial institutions. The TIHC offered financial products which resembled those of institutions covered by deposit insurance. The Board of Directors and management clearly recognized they were taking deposits.

Also called into question is the trust company purchase. In April 1983, the TIHC purchased Norfolk Trust Company for a total of $11 million. Management and the Board advised that the trust company was purchased in response to membership demand for trust services. They could not provide those services by hiring a licensed trustee because a co-operative may not directly carry on the business of a trust company.

However, investment in Norfolk Trust was not the first made by the co-operative. In 1974, it had federally incorporated the Teachers' Trust Company which later became known as Discovery Trust. The rationale reported for the Norfolk Trust purchase was to allow the TIHC to operate in Saskatchewan, expand eventually into Ontario, and broaden its financial base. The

TIHC knew there were problems with trust companies in Ontario which they felt could be avoided with the purchase of a full-service company. Ontario froze trust company registration before the TIHC could act.

In December 1983, Norfolk Trust merged with Discovery Trust and became known as Discovery Trust Company of Canada. That year, the trust company made a profit but escalating loan losses in subsequent years required increasing reserves. By 1985, the directors report that loan loss was so high, they felt they had to sell the company to save the co-operative's capital base. Unfortunately, the value of western regional trust company assets fell considerably during this period. In 1986, Discovery Trust was sold at a loss.

As with the 1972 investment in a trust company, the TIHC received approval under section 13 of the Co-operative Association Act from the Superintendent of Co-operatives for this purchase. Although there was a precedent for this type of investment, it differed in degree. In retrospect, it is the opinion of the Superintendent of Financial Institutions that the co-operative had an insufficient capital base to support such an operation and that the purchase stretched its mandate and threatened its future solvency.

2.0 Business Practices

The Superintendent's conclusion is that several aspects of investment practices were imprudent given the nature of member accounts or "investments." No evidence exists that this imprudence occurred intentionally. Nevertheless, it remained unmitigated by a number of factors and was exacerbated by the economic recession in western Canada.

(a) Member Mortgages:

Historically, the co-operative was successful in meeting its primary objective of providing mortgages to teachers. A thorough residential mortgage policy manual existed. Traditionally, the portfolio performed excellently. The Interim Receiver's restructuring proposal notes that at November 4, 1985, there were only four of approximately 2,700 mortgages in this portfolio in arrears for more than 90 days.

(b) Commercial Loans:

In the 1960s, the TIHC decided to diversify from member loans; the membership passed an extraordinary resolution to accept commercial members as borrowers. The Board advised of the existence of a detailed commercial loan

policy to require detailed evaluations, checks on property, a cap on individual loans, and investigation of borrowers.

A commercial loan manual was developed by the co-operative in 1983. There is no evidence on file, however, to indicate that all procedures in this manual were followed for all loans. In fact, there appear to have been procedural omissions. Specifically, the majority of files were absent financial statements of the company or evidence of their review. The co-operative did not always rely on appraisals.

The TIHC was also on notice that some of its procedures were not in accordance with standard practice. Communication between the Credit Union Reserve Board (CURB) and the TIHC in 1983 notes that the TIHC neither maintained reserves for doubtful accounts, nor provided sufficiently detailed expense statements to show write-offs for bad debts. The rationale was that no first mortgage loans had ever been lost and that when commercial loans went bad, sufficient equity for recovery was present.

The CURB analysis suggests that commercial loans were an increasing percentage of the co-operative's assets. This reflected a change in the nature of the co-operative's business. According to TIHC's financial statements, provision for loan loss for commercial loans began in 1982. This provision did not reflect the increase in commercial mortgages from 19 per cent of the total mortgage portfolio in 1970 to 30 per cent by 1982.

In general, however, evidence suggests loans appear to have been commercially reasonable at the time they were made. Despite a number of documentary deficiencies, the Interim Receiver concludes that loan files are within the quality range normally found in credit unions in British Columbia. The auditors also say they found the files adequate.

(c) Real Estate:

When the co-operative dissolved, nearly one-quarter of its assets were in real estate. Book value of rental properties was $21.3 million; of development properties, $46.5 million. The latter portfolio contained five properties, all but one purchased in 1981, and located in Calgary, Alberta. (Two of these properties were booked at $14.4 million and $17.7 million respectively.) By

December 1985, the rental properties were appraised at $16 million. In stark testimony to the Western Canadian recession, the development properties were valued at a total $9.2 million, a write-down close to $43 million.

The Board and management reported the co-operative had been involved in land and property since its inception in 1951. However, the nature and degree of that involvement changed dramatically in its last decade of operation. According to the 1970 annual report, close to 10 per cent of the co-operative's assets were in the form of agreements receivable from the sale of properties, and rental properties. Rental properties comprised 2.5 per cent of the total assets. Prior to development property purchases in 1981, approximately 13 per cent of the TIHC assets were in real estate; the vast majority in rental properties. After the 1981 joint ventures, 22 per cent of the co-operative's assets were devoted to real estate; the majority in development properties.

The Board and management informed the Superintendent that decisions to invest in development properties were not taken lightly, but were based on forecasts and expert advice recommending land as a hedge against inflation. The Superintendent concludes, for several reasons, that these investment practices were imprudent and were a major factor in the eventual failure of the co-operative.

The Board's perceptions that these investments were based on careful appraisals and in consideration of the expert advice of partners (whom the Board believed to be "well-known developers" in Alberta) were not borne out. There is no evidence that outside appraisals were received for these properties. The well-known developers were, in reality, real estate salesmen with no direct development experience. Management suggested there was "no point" in conducting appraisals; the joint venture partners had received glowing reports in magazines and had a strong net worth.

Contrary to Board and management perceptions, investment in raw land is a high risk investment. By prudent standards for financial institutions, the reserves of the TIHC were inadequate to fund investments with this degree of risk. By credit union standards (the most comparable institution) this land investment far exceeded standard reserve practices. Compared with conservative investment limits of 20 per cent of reserves allocated to one investment, the TIHC had invested over 400 per cent of its reserves in five development properties.

Internal control procedures, which fully satisfied Board and management, proved inadequate. The Board met over 60 times a year yet much of the information they report to be the basis for investment decision-making does not seem

to exist on file. There was no internal auditor. The presence of legal counsel at each meeting could never have been intended as a source of investment expertise.

The considerable collective experience of the Board as Board members was apparently insufficient to compensate for their lay nature when it came to operating the extensive financial institution the TIHC had become. There is little evidence the Board saw fit to challenge management actions over a long period of time. On the contrary, they had passed a resolution in March, 1980 providing the Chief Executive Officer with "full power and authority to sell and purchase real property as he finds necessary."

The auditing system appears to have been an inadequate external control on the operations of the TIHC. The TIHC employed several accounting practices which, while in accordance with General Accepted Accounting Principles (GAAP), must be judged as inappropriate given the TIHC operated as a financial institution where people invested their savings.

Other practices did not conform to the GAAP. For example, the cooperative used a five-year averaging loan loss policy. No depreciation was booked on real estate. As well, interest was capitalized on the development property whose net realizable value (NRV) was measured

using future value -- a more difficult and riskier calculation than cash price. Such practices cannot have contributed to a clear picture of the cooperatives financial situation.

There is also evidence from the minutes of the Board of Directors that the auditors may have intended to issue a qualified opinion on the 1984 financial statements. The auditors were concerned about the carrying value of assets, particularly on certain development properties. The nature of discussions between the Board of Directors, the auditors and management is unknown. The outcome is not -- the financial statement for 1984 was unqualified. Notes to the financial statement point out the development properties were not marketable at their carrying value, but that the directors and management anticipated recovery within three to five years. Instead of providing the warning signals it could have, the 1984 report may have lulled the Board, management and ultimately, investors, into a false sense of security.

3.0 Misrepresentation

A number of allegations have been made of misrepresentation to investors. No evidence came to light in this inquiry of intentional or fraudulent misrepresentation to investors. However, there are a number of important sources of confusion. The overriding source of confusion is that the TIHC looked and

acted like a financial institution in a number of ways. The public perceived the co-operative to be stringently regulated when, in fact, the TIHC was operating without a safety net of any kind.

The co-operative's early history reveals legitimate reasons why it was not established as a credit union. It is the Superintendent's view that these reasons were no longer valid once deposit insurance was created in the 1960's, especially in light of the TIHC's considerable expansion thereafter.

It is not clear why the co-operative continued to expand financial services without deposit insurance, or why it did not convert to a credit union if that was the only avenue by which it could secure coverage. The only rationale seems to have been a reluctance to conform to narrower requirements under the Credit Union Act. Under this Act, the TIHC would have been unable to operate extra-provincially, and subject to regular inspections. It would also have been required to maintain a statutory per cent of assets in liquid form, and prohibited from making investments such as land, lease holds, common shares (beyond its associated or subsidiary corporations) and foreign exchange.

Misperception about the nature of the TIHC was fuelled by confusion in other areas. One of these was the relationship between the B.C. Teachers' Federation (BCTF) and the co-operative. The TIHC was first incorporated through efforts

of the BCTF. Although the two organizations were legally separate entities, they were fused in the minds of many teachers and investors.

The BCTF advertised for the co-operative. Both offices were physically located in the same building for a number of years. The TIHC was present at teachers' conventions and held annual dinner meetings with presidents of teachers' associations from Alberta, Saskatchewan, Manitoba and Ontario as well as British Columbia. The Retirement Savings Plan was developed in 1968 at the request of the BCTF. Although the BCTF was not represented on the Board of the co-operative, a BCTF representative sat on the Retirement Savings Plan Monitoring Committee (the equity portion). The plan was named "The BCTF Retirement Savings Plan" until 1980 when, for marketing purposes, it was renamed "The Teachers' Retirement Savings Plan."

The Superintendent concludes that efforts to disentangle the BCTF from the co-operative in the eyes of its investors, were not necessarily successful. The TIHC continued to enjoy the perception of stability and respectability conveyed by the belief it had a strong tie with the BCTF and equivalent associations in other provinces.

Confusion also surrounded the Retirement Savings and the Deferred Salary Leave Plans created in 1969 and 1980 respectively. Montreal Trust acted as the trustee for these

plans from 1969 until December 31, 1981, when it resigned in favour of Discovery Trust. In June, 1985, Montreal Trust resumed trustee responsibilities for these plans, as well as the registered home owner savings and employee pension plans.

Although co-operative investors saw one trustee, the trust arrangements for the Retirement Savings Plan differed considerably from that for the Deferred Salary Plan. In the former, the trust agreement provided for funds to be invested in the notes of the co-operative. In other words, the trustee acted primarily as a conduit for unsecured funds. The arrangement for the Deferred Salary Plan, however, provided that funds held would be fully secured. This arrangement was made in 1985 to meet school board concerns about liability.

It is not hard to understand how the terms of these two trust arrangements may have become confused in the minds of investors who participated in both plans. Although the TIHC reports it urged investors to read the declaration of trust before they participated in the Retirement Savings Plans, investors do not always understand the role of a trustee and often erroneously believe a trust arrangement to be equivalent to a guarantee. The absence of deposit insurance made this situation an even greater problem. Nevertheless, the Superintendent also acknowledges that investors must take some responsibility for understanding the conditions under which

they invest, and for finding out whether deposit insurance exists.

Financial statements for 1984 also caused confusion. For knowledgeable readers, these statements showed the TIHC was experiencing severe financial difficulties. In addition to the losses sustained during the year, real properties, the trust company, and securities were carried at more than their market value.

Board minutes include minutes of a March, 1985, meeting of the audit committee with management personnel and the auditors. Other members of the Board of Directors attended but did not participate in discussion. According to these minutes, discussions were held with respect to the following:

(1) Consolidation of Discovery Trust and TIHC (Arizona) Inc. on an equity basis.

(2) Pooling of assets with respect to certain designated properties.

(3) A decision that the auditors statement not be qualified.

(4) Rates of interest being capitalized on certain properties being held for development.

(5) Proposed notes to the statement and, in particular, the note dealing with ongoing operations.

During the Board meeting which followed, it was moved that the 1984 financial statements be prepared showing Discovery Trust Company of Canada and TIHC (Arizona) Inc. as consolidated equity. Certain assets were to be segregated into a separate

pool to be accounted for on a cost recovery basis. Mr. Justice Estey found similar methods, particularly reliance on future values, to be unconventional and problematic during his inquiry into the collapse of the Canadian Commercial and Northland Banks.

The Superintendent recognizes the difficult position of the auditors who contemplated issuing a qualified statement on the basis of the 1984 performance, but who did not wish to trigger the downfall of the organization. Nevertheless, the financial notes about development and other properties, and about ongoing operations, cannot be said to have been in the best interests of those few investors who read them. In the opinion of the Superintendent of Financial Institutions, these statements are particularly creative. While they may be judged to meet legal and professional standards of disclosure, it is doubtful members would be able to understand how severely troubled the TIHC was. For this, the Board of Directors must share responsibility.

While confusion was not maliciously, nor perhaps consciously perpetuated by the Board, management or staff of the TIHC, two aspects must be noted. The first is that beyond Retirement Savings Plan declarations of trust, the co-operative had no direct communication with non-members. These investors were unable to learn from even the limited circulation of the annual report. Secondly, there is no evidence that the

co-operative made a conscientious effort to communicate to its members that t[illegible]r funds were at risk. Board and management must take some responsibility for these deficiencies.

4.0 Criminal Acts

The Corporate Investigations Branch of the Ministry of Finance and Corporate Relations investigated aspects of the cooperative's joint ventures in Alberta real estate. The Branch also examined whether TIHC management, directors or officers made fraudulent withdrawals of personal funds during the 1984-1985 period.

No evidence was found of any statutory offences, in these areas, on the part of the Board of Directors, management or any other persons involved with the operation of the Teachers' Investment and Housing Cooperative.

5.0 Deposit Insurance

For over a decade, the TIHC pursued deposit insurance. Because the TIHC was ineligible for coverage by the Canadian Deposit Insurance Corporation, and private insurers do not insure financial institutions, the quest was focussed primarily within British Columbia.

One theme appears constant -- the TIHC was not a credit union. This created what were ultimately insurmountable technical and political problems with respect to qualifying for deposit insurance. It is not clear whether the TIHC couldn't or wouldn't become a credit union. Nevertheless, it didn't become one, thereby remaining uninsured and vulnerable to the eroding investor confidence which contributed to its demise.

The TIHC identifies a series of obstacles which they say they attempted to overcome unsuccessfully. The first obstacle was the narrow Credit Union Reserve Board powers under the Credit Union Act. In June, 1977, the TIHC actively supported an amendment to the Credit Union Act [section 136(3)] which enabled application of the Provincial Credit Union Share and Deposit Guarantee Fund to a corporation having objects similar to a credit union. The TIHC then actively began to negotiate for this coverage.

During this time, the Ministry of Consumer and Corporate Affairs appears to have cautiously supported the TIHC's request to CURB, subject to three key conditions being met: divestiture of its federally incorporated trust company; negotiation and compliance with terms and conditions for deposit insurance to make the TIHC more compatible with a credit union; and satisfactory resolution of various issues about extra-provincial operations.

Minutes of the TIHC Board of Directors show a trail of correspondence between the co-operative and CURB which ultimately ended in CURB's refusal of TIHC's application for deposit insurance in October, 1979, for the second time in as many years.

In late 1979 and early 1980, government discussions began on the issue of creating a crown corporation for deposit insurance to replace CURB. The TIHC participated in the resulting task force, and proposed that an interim guarantee be provided by the government until such time as the Crown corporation was formed. In a May, 1980 letter to the Chief Executive Officer of the TIHC, the Assistant Deputy Minister, Corporate Affairs, suggested an interim solution would be the signing of a contract between the government and a co-operative without regulations being required. Concern was expressed, however, about required reserve levels and the issue of the TIHC's investment mix. The letter reads: "your present asset mix promotes long-run instability, and this is the very mix that your memorandum proposes to retain. We would require that a guarantee arrangement include a mechanism to adjust your asset mix over time towards one more appropriate for the co-operative as a near bank." Eventually, the government decided to wait until the proposal for a Crown corporation for deposit insurance ran its course.

The differences between CURB and the TIHC appeared substantial. Evidence of how remote an agreement must have been, appeared in minutes of a February, 1981 meeting between the Ministry of Consumer and Corporate Affairs and the Credit Union Reserve Board. The minutes note the crux of the problem was TIHC's refusal to "look like a credit union." This was identified as a potential threat to the insurer's financial base, as well as an issue that might have caused CURB problems within the movement. Negotiations between the two parties had earlier broken off over questions of discretionary powers and other matters of principle. The most problematic area continued to be investment powers. For example, the TIHC wanted to maintain a $22 million investment "pool" on which it would not accept any restrictions.

In March, 1982, the TIHC sent a letter to the Deputy Minister of Consumer and Corporate Affairs to again request an interim guarantee; this time to be accompanied by a sinking fund. Applications to, and negotiations with CURB continued. The Board of Directors minutes contained correspondence from CURB to the TIHC dated March 7, 1983, complete with a risk analysis of the co-operative. The probability of distress was estimated at 60 per cent. This analysis concluded that "extending deposit and share insurance to TIHC would substantially increase the likelihood of a claim against the Provincial Credit Union Guarantee Fund."

The Superintendent has not been able to determine how the TIHC responded to this analysis, but it seems nothing materially changed in these negotiations from the time they began in 1977 until January 1984. At that time, TIHC's Board studied the possibility of converting to a credit union or to a federally incorporated financial institution. In March 1984, one more application to CUDIC was made but refused. The co-operative presented too great a risk to be granted coverage without some other guarantee. In October of that year, the TIHC also approached Lloyds of London.

In the spring of 1985, another application was submitted to CUDIC and several meetings held with Ministry officials and the Minister. Handwritten notes adjoining the minutes of the Board meeting of April 16, 1985, list disadvantages to CURB coverage. These disadvantages included possible loss of stock trading profit, supervision and regulation, payment to CURB's capital account, advertising restrictions, and difficulties operating extra-provincially. Issues which seem to have prevented insurance coverage from the beginning, remained the same.

According to earlier analyses, the government felt it could not justify insuring the TIHC because the legal restrictions placed on credit unions would have been waived. The re-insurance scheme or government guarantee may have been an option, but CURB felt it would cause serious problems because

credit unions did not have similar guarantees. Ultimately, the government could not justify treating the TIHC differently than credit unions. Like the other parties involved, the government does not appear to have changed its views about the terms and conditions of deposit insurance over the years, nor did it do so at the end.

One dilemma for the government was a recognition that the TIHC was a major B.C. deposit-taking institution. Deposit insurance was crucial. At the same time, the TIHC was an investment vehicle and the government cannot guarantee such ventures.

CONCLUSIONS

The problem of the Teachers' Investment and Housing Co-operative was evolutionary. The decline in real estate values and the weakness in commercial loans caused by the Western Canadian recession contributed to the co-operatives demise. But, the underlying problem was the TIHC had expanded and diversified beyond its resources and skills. It had been extremely successful at its specialty of providing mortgages for teachers, but had neither the skills to cope with its eventual role as a major financial institution nor the safety net of deposit insurance if it failed.

One cause of the problem was that decisions which fundamentally changed the nature of the operations of the TIHC were not seen to be so. This is particularly true for the purchase of development properties in Alberta and the 1983 purchase of the trust company. Although these decisions may have been seen at the time as incremental expansions of existing practices, their impact on the co-operative's operations was fundamental. No one involved appears to have realized this, including the board members, management or provincial government. The Superintendent believes this is partly because the TIHC operated under a statute which neither enabled nor required the detection of these kinds of circumstances.

The Superintendent's conclusions are outlined below:

1. The Board of Directors operated in good faith. They were very committed to, and very involved in the affairs of the co-operative. Nevertheless, the success with which they held management accountable must be questioned. In particular, the Board stressed its conviction that the TIHC needed a diversified portfolio. The portfolio was not, however, well diversified, because a large proportion was invested in the high risk land deals which ultimately contributed to the failure of the co-operative.

Also of note in this context is the deposit insurance issue. The onus must be on deposit-taking institutions to qualify for insurance. Given its extensive deposit-taking activities, the Superintendent believes the TIHC should have taken the steps necessary to qualify for deposit insurance as soon as it existed. The argument that the TIHC offered "deposit-like" accounts before the existence of deposit insurance and was trying to secure this insurance, is not valid for the co-operative's continued expansion into deposit-like financial products. The Board of Directors should not have allowed the TIHC to expand these financial services without first obtaining deposit insurance.

Behind these problems lay not intentional carelessness, but what appears to have been tunnel vision and insularity. Many of the Board members had over twenty years of Board experience but it was like one year's experience twenty times over. The Board's opinion that development property was a conservative investment illustrates how little knowledge they had; how much they relied on management as a primary source of information; and how far beyond their skills they were operating.

2. Certain business practices exacerbated problems faced by the TIHC. The co-operative's limited capital base was incompatible with the nature of its investments. The

absence of an internal auditing system provided no additional feedback for the benefit of the Board. No external independent information and advice existed to mitigate these problems. The presence of legal counsel at all Board meetings seems to have provided a security blanket but may also have hidden the fact that legal and investment advice are not equivalent.

3. Co-operative investors were not deliberately misled, but neither were they diligently informed about the level of investment risk. Investors in the TIHC would not be classified as sophisticated investors, and the onus should be on the institution for a higher level of information disclosure. Auditors' financial statements, trust relationships with different levels of security for some investors, and the perceived association of the BCTF did not contribute to clear communication between the co-operative and its investors. The careful, cautious nature of member investment, and the riskier nature of TIHC investment were fundamentally incompatible.

4. The Co-operative Association Act is enabling rather than regulatory. Government action is particularly limited and Superintendent and regulatory powers are weak under this Act. The Co-operative Association Act was not intended to provide for the operation of a financial institution.

RECOMMENDATIONS

Lessons about financial institutions and about legislation can be learned from the story of the Teachers' Investment and Housing Co-operative. Specifically, the Superintendent recommends:

(1) Information about the meaning of trust relationships should be required to be disclosed by financial institutions to their customers.

(2) The role of the auditor in a financial institution should be more carefully delineated to ensure the function of external control -- independence and obligations to members or shareholders -- remains paramount. Higher standards of communication should be required between auditors, regulators and investors.

(3) The application and appropriateness of generally accepted accounting principles (GAAP) to financial institutions should be evaluated.

(4) Higher standards of care should apply to Boards of Directors of financial institution than for other institutions.

(5) Investment practices of financial institutions should be closely monitored according to prudent portfolio standards. Regulatory and stabilization procedures should be designed to allow imprudent transactions to be rectified immediately.

(6) Investors should actively seek information concerning conditions under which they invest, particularly the degree of risk and the existence of insurance.

A lesson about legislation is that the public may be unable to distinguish between regulatory and enabling acts. Statutes designed for minimal government intervention should provide power to investigate and seek remedy should serious problems arise. Specifically the Superintendent recommends that:

(1) Legislation should not allow a financial institution, whatever it is called, to escape close regulation and monitoring.

(2) The Co-operative Association Act should not be a vehicle for establishing and operating a financial institution.

(3) The Co-operative Association Act should be amended to clearly prohibit operation of a deposit-taking or financial institution under its auspices, and to provide the Superintendent with appropriate powers and remedies to prevent another case like that of the Teachers' Investment and Housing Co-operative.